Office of Chief Counsel Internal Revenue Service

memorandum

CC:LM:NR:DAL:PREF-126193-02 TALudeke

date: July 17, 2001

to: Carol Paulson Revenue Agent

from: Associate Area Counsel
Natural Resources

subject: Decision Date Analysis

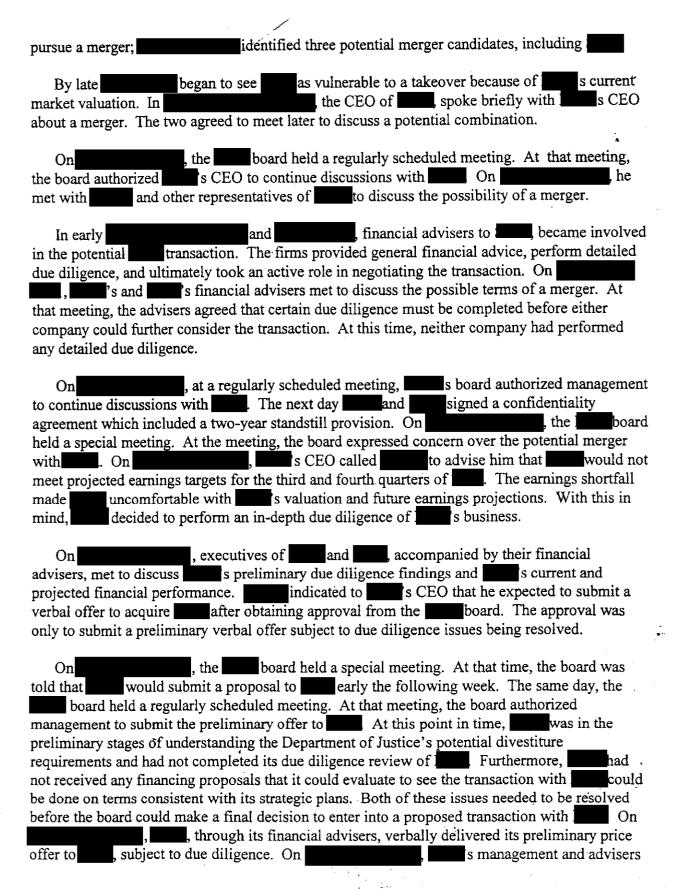
This memo responds to your request for assistance of July 2, 2002. It should not be cited as precedent.

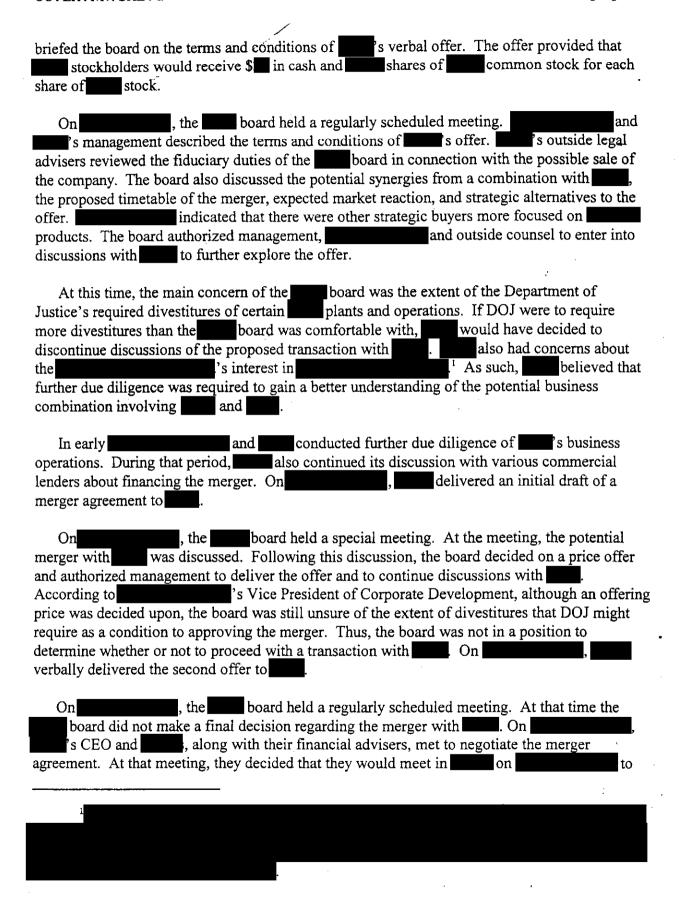
You asked for assistance in determining the proper decision date for the merger between and you also requested our assistance in determining a method for allocating the fees incurred by and you also requested our assistance in determining a method for allocating the fees incurred by and you are for and you are for you also requested our assistance in determining a method for allocating the fees incurred by and you are for you are for

STATEMENT OF FACTS

and first entered into a confidentiality agreement on agreement included a three-year standstill provision. In early and and terminated their negotiations primarily due to differences over integration and management succession issues. No due diligence was performed at this time.

On hired to assist it in connection with a possible transaction with a or another firm. It also examined other financial alternatives for that meeting, a presented several financial alternatives to the board held another regularly scheduled meeting. At that meeting, a presented several financial alternatives to the company. One of the alternatives was to





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finalize the merger agreement. On during that meeting, and meeting and meeting of the board authorized someone suspended their merger discussions. The next day, at a special meeting of the board, the board authorized someone someone someone with the meeting on the meeting on the meeting on the meeting on the meeting of merger agreement. The same day, the board held a special meeting to discuss the state of the merger negotiations. The board authorized management to continue its negotiations with the meeting and agreed to meet again on to consider approving the final transaction.
On again, and the companies suspended their merger discussions. It requested that certain key employees be given bonuses and other employees awarded severance packages. It also believed its operations justified a higher price than in the current offer. With these requests in mind, believed that the transaction was not feasible and decided to terminate discussions with the latter than the board held a special meeting. Though no issues were resolved at that meeting, the board authorized is management to resume discussions with to further discuss the issues raised on During that conversation, they reached agreement on several issues. The same day, is board held a meeting to discuss the status of the merger negotiations. The board authorized management to continue negotiations with
From to April 3, 2001, so is and so is executives and advisers continued negotiating the merger agreement. On the merger between and so closed. It is shareholders ultimately received \$ in cash and shares of stock - the same terms included in the stock preliminary offer that was made on the stock - the same terms included in the stock preliminary offer that was made on the stock - the same terms included in the stock preliminary of the stock - the same terms included in the stock preliminary of the stock - the same terms included in the stock - the same terms in the stock - the same te
ANALYSIS
provided a lengthy memo that it claims support using as the decision date for the merger. According to prior to the prior to the companies had not decided whether to enter a new business or which new business to enter. Guidance for determining the appropriate decision date is provided in Rev. Rul. 99-23, 1999-1 C.B. 998 and one of a half and and Wells Fargo & Co. v. Commissioner, 224 F.3d 874 (8th Cir. 2000).
Rev. Rul. 99-23 addressed three different factual situations. In the first situation, in April 1998 a corporation, U, hired an investment banker to evaluate the possibility of acquiring a new
² Though discusses the whether and which test, it doesn't claim that and ever investigated merger partners outside their industry. Thus, the only real issue is the date the firms focused on a combination of their assets.

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business. After a lengthy investigation, U focused on companies in a specific industry. The investment banker evaluated several businesses in that industry, including V. The investment banker commissioned appraisals of V's assets and commenced an in-depth review of V's books and records in order to determine a fair acquisition price. On November 1, 1998, the U entered into an agreement with V to purchase all of its assets.

In the second situation, corporation W began searching for a trade or business to acquire in May, 1998. Anticipating finding a suitable target, W hired an investment banker to evaluate three potential alternatives. At the same time, W hired a law firm to begin drafting regulatory approval documents. Eventually, W decided to purchase X.

In the third situation, Y hired a law firm and accounting firm to assist in the potential acquisition of Z by performing services the parties labeled "preliminary due diligence." These services included conducting research on Z's industry and analyzing financial projections for Z for 1998 and 1999. In September 1998, at Y's request, the law firm prepared and submitted a letter of intent to Z. The offer contained in the letter resulted from prior discussions between Y and Z, specifically stated that a binding commitment with respect to the proposed transaction would result only upon execution of an acquisition agreement. Thereafter, the law firm and accounting firm continued to provide services labeled as "due diligence," including a review of certain documents of Z. On October 10, 1998, Y entered into an acquisition agreement with Z to purchase all of its assets.

Before analyzing the three situations, the FSA set forth a general rule for determining when expenditures incurred in the purchase of the business should be capitalized. This determination centers upon whether expenditures were incurred before or after the decision was made whether to enter a new business and which new business to enter:

[E]xpenditures incurred in the course of a general search for, or an investigation of, an active trade or business, i.e., expenditures paid or incurred in order to determine whether to enter a new business and which new business to enter (other than costs incurred to acquire capital assets that are used in the search or investigation), are investigatory costs that are start-up expenditures under § 195. Alternatively, costs incurred in the intent to acquire a specific business are capital in nature and thus, are not startup expenditures under § 195. The nature of the costs must be analyzed based on all the facts and circumstances of the transaction to determine whether it is investigatory costs incurred to facilitate the whether and which decisions, or an acquisition cost incurred to facilitate consummation of the acquisition. The label that the parties used to describe the cost and the point in time at which the costs is incurred do not necessarily determine nature of the cost.

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In Situation 1, the Service determined that Y made its decision to acquire V after the investment banker conducted research on several industries and evaluated publicly available financial information. It noted, "[t]he costs incurred to conduct industry research and review public financial information are typical of the costs related to a general investigation," *Id.*, and were eligible for amortization as startup expenditures under § 195. But the costs related to the appraisal of V's assets and review of V's books and records were capital acquisition costs.

Importantly, the Service noted that if the evaluation of V's competitors occurred after the decision to acquire V was made, those costs were capital.

In Situation 2, the Service determined that the costs incurred to evaluate potential businesses were investigatory. The cost of drafting regulatory approval documents, however, even if incurred prior to the time W decided to purchase X, were not start-up expenditures, but were facilitative of the purchase and were capital.

The third situation is the most factually nuanced of the three. There, the Service determined that Y made its decision to acquire Z in September 1998, around the time that it instructed its law firm to prepare and submit a letter of intent. The due diligence costs incurred prior to that time "are typical of the costs incurred during investigation to determine whether to acquire a new business and which new business to acquire," *Id.*, and are investigatory. Due diligence costs incurred after that time, however, related to the attempt to acquire Z and must be capitalized.

Wells Fargo addressed a more complicated factual situation concerning the merger of Davenport Bank and Norwest. Davenport was a small bank located in Iowa. In 1989, when the state of Iowa adopted interstate banking legislation that allowed the acquisition of Iowa-based banks by out-of-state banks, Davenport feared that banks of its size would no longer be competitive. As a result, Davenport began to consider the idea of merging with another bank.

During 1990, Norwest and Davenport began the talk about merging. On June 10, 1991, Davenport's Board of Directors met to consider merging into Norwest. The board authorized the firm's executive directors to negotiate with Norwest and to hire legal and other representatives with the intent to recommend to the board a letter of intent between Davenport and Norwest. The board also appointed a committee to perform an independent due diligence review. On the same day, Norwest's Board of Directors authorized using up to 10 million shares of Norwest common stock to purchase Davenport.

On July 22, 1991, Davenport's board met to consider the merger. At that meeting, the special committee recommended that the transaction be approved and Davenport's banker opined that the transaction was fair to Davenport's shareholders. The board approved the transaction.

On the same day, Norwest entered into an agreement whereby they agreed to the transaction subject to regulatory approval, approval of Davenport shareholders, and the satisfaction of certain conditions including regulatory approval and accounting and tax considerations. Norwest also entered into an agreement with certain shareholders of Davenport that agreed to vote in favor of the transaction and issued a press release announcing the merger. After signing the agreement,

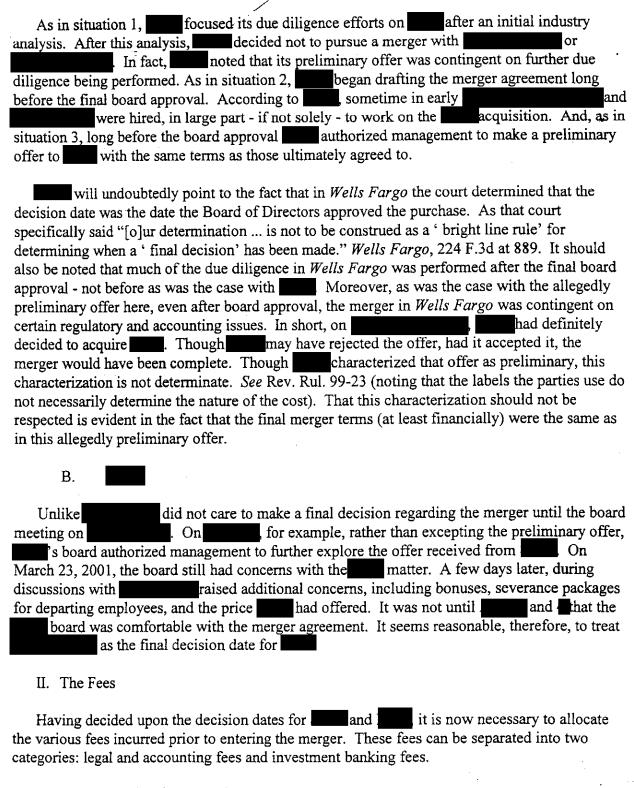
Norwest commenced a due diligence review of Davenport which continued throughout August.

In order to determine which expenses should be capitalized the court applied revenue ruling '99-23, noting, "this Court agrees with the IRS than any investigatory expenses which post-date the 'final decision' to acquire a business ought to be capitalized." *Id.* at 889. Thus the court had to determine the final decision date. With little analysis, the court concluded that the final decision date was July 22, 1991, the date Davenport and Norwest entered into the Agreement and Plan of Reorganization. The court did note that "[o]ur determination on this point is not to be construed as a 'bright line rule' for determining when a 'final decision' has been made. The facts and circumstances of each case must be evaluated independently to make a proper finding on that issue." *Id.*

I. The Decision Date

Here, there are two decision dates that are relevant:
A. •
In early first began to consider purchasing At this date, was also considering purchasing at least two other companies. After performing an initial due diligence on these companies, however, it chose not to consider purchasing them. Even as early as then, was already more-or-less focused on In late began to see as a potential takeover target because of its current market valuation. In spoke briefly with Section 2001 about a merger.
In early and and became involved in the potential transaction. On some solution is board authorized management to continue discussions with solution. On the solution of the s
By February 22, therefore, was prepared to purchase Though the transaction was not consummated until six weeks later, under the relevant authority, the correct decision date.

The various situations in the revenue ruling all support the conclusion that decision date. Though the facts are somewhat abbreviated, in situation 1, the Service held that the cost of appraising the targets' assets and an in-depth review of the targets' books and records were capital acquisition costs. In situation 2, the Service held that the process of drafting documents related to the merger- even those occurring before the final decision date - were capital. In the third situation, the Service determined the decision was made at the time the acquirer instructed its law firm to prepare and submitted a letter of intent. Each of these situations can be applied to the decision.



A. Legal and Accounting Fees

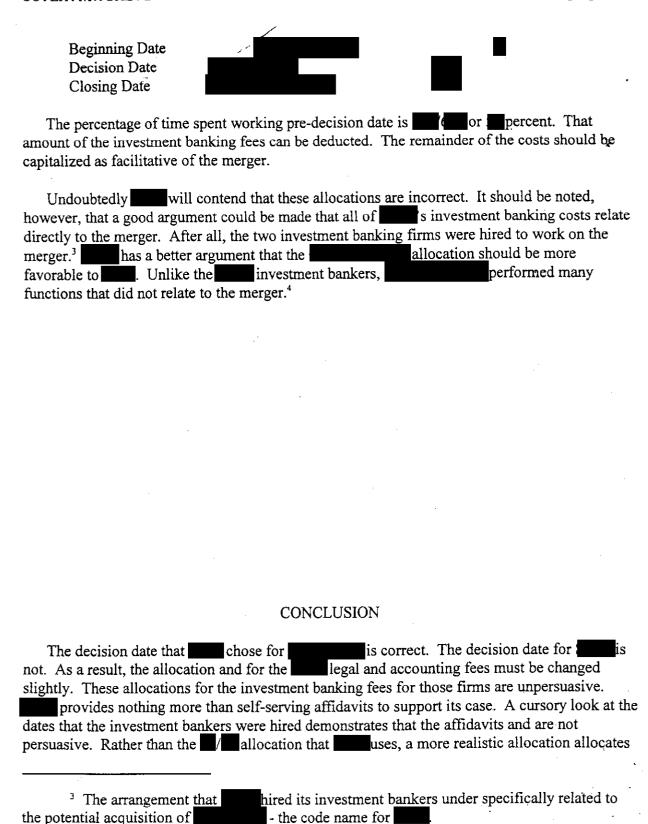
Legal and accounting fees are similar in that they both are based upon invoices that reference

the dates the services were performed. Thus it is easy to determined whether expenses in these categories were performed before or after the decision date. The has already allocated expenses in these categories that were performed prior to the decision date into ordinary (or amortizable) and capital. Though we might disagree with certain of these allocations, it's unlikely that any disagreement would lead to a material difference. Thus, the best method for allocating these fees is to accept allocation of the pre-decision date fees. The only change necessary, therefore, is to ensure that all fees incurred between and by and fees prior to can be accepted as provided in substitute as submission.
B. Investment Banking Fees
Unlike the legal and accounting fees, the investment banking fees were not broken down by date. Rather, the fees were based upon a successful completion of the merger. Thus there's no way to break down the fees by examining detailed invoices. But the fees can be allocated by date.
Allocating the fees by date requires analyzing s and s s fees separately. Not only did the decision dates differ for the two firms, but their respective investment bankers also started working on different dates. The only consistent date between the two firms is - the date the merger closed.
1.
's investment bankers began work in early . I finally decided upon the merger on . Using as the starting date for the investment bankers, the fees can be allocated as follows:
Beginning Date Decision Date Closing Date
The percentage of time spent working pre-decision date is percent. That amount of the investment banking fees can be amortized. The remainder of the cost should be capitalized as facilitative of the merger.
2.
hired on on fees can be allocated as follows:
Days Expired

⁴ The arrangement had

hired

financial advice as well as assistance with a potential merger with



required

to provide general

or another firm.

almost all of sinvestment banking fees to the merger. should also be allocated to the merger at a higher percentage than proposes.

This advice is subject to post review by the National Office. This procedure takes ten days and I will notify you if the National Office does not agree with this advice. If you have any questions regarding this memo, please contact Todd Ludeke at (972) 308-7926.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

John S. Repsis Associate Area Counsel (Large and Mid-Size Business)

By:_____ TODD A. LUDEKE Senior Attorney